# HOUSING MARKET OUTLOOK

Halifax - Fall 2005

## Apartment Construction Rebound to Continue While Single Starts Sag

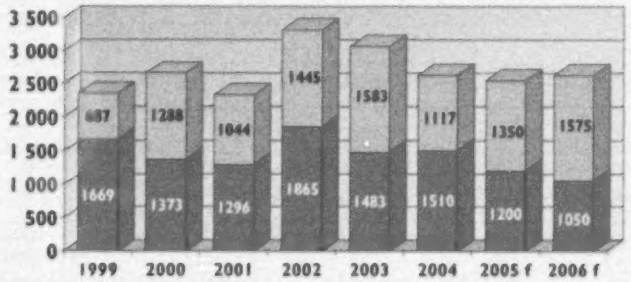
### NEW HOMES MARKET OUTLOOK

Residential construction activity has remained quite healthy this year and this is expected to continue in 2006. Total housing starts are on track to end this year at 2,550 (down only 3 per cent from last year) before edging up 3 per cent next year to 2,625. A strong rebound in apartment construction this year has largely offset sagging single-detached homebuilding and this phenomenon is forecast to continue throughout next year. While rising costs will once again challenge developers and builders next year, price growth is expected to moderate as consumers become increasingly price sensitive and budget conscious.

Tremendous growth in the inventory of existing homes listed for sale and a scarcity of serviced building lots has slowed the pace of single-detached homebuilding considerably this year. Single starts are expected to end the year down 21 per cent from last year at only 1,200 units. With the majority of intending homebuyers expressing a preference for existing homes, the rapid expansion in active MLS® listings over the past 12 months has satisfied a greater share of total home ownership demand. This has reduced one of the driving forces behind the elevated level of single starts in recent years. However, the thin inventory of building lots- especially serviced building lots under $75,000- has also contributed to the decline in single starts. Tight serviced building lot supply conditions have generated significant lot price inflation over the past 18 months making it increasingly difficult for builders who purchase lots from developers at premium prices to deliver an attractively-priced home to progressively more price-sensitive homebuyers.

**Multi Unit Construction Rebound Will Buoy Total Housing Starts**

Single and Multiple Unit Housing Starts, Halifax CMA




Source & Forecast: CMHC

Through the first nine months of this year single-detached housing starts are considerably lower than through the same period last year in most areas of Metro except the outlying county areas east of Dartmouth and southwest of Halifax. While a slight improvement may be in sight for Dartmouth next year with several new subdivisions forecast to break ground, little relief is anticipated for other areas. With a slight expansion in existing home inventory and a slight contraction in the inventory of serviced building lots expected to occur over the next 15 months, single-detached housing starts are forecast to languish again next year sliding another 13 per cent to only 1,050 units- the lowest annual output in 15 years.

Rental apartment construction has rebounded impressively from a fairly low level last year while condominium starts and combined

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semi-detached and row starts are on track to match 2004's activity levels. As a result, total multiple unit housing starts are poised to end the year 21 per cent higher than last year at 1,350 units. Looking ahead to next year, multiple unit starts are forecast to increase another 17 per cent to 1,575 units. While activity in the rental and middle-density (semi-detached and townhouse) segments is expected to hold relatively steady in 2006, there are numerous large condominium projects scheduled to begin construction, boosting condo starts 63 per cent to a forecast 650 units.

As detailed in the *Rental Market Outlook* and *Condominium Market Outlook* articles in this edition, it is not clear that short-term demand conditions are supportive of the current and anticipated growth in the condo and rental stock over the next two years. However, rising land prices are forcing developers to pursue higher density projects and some are choosing to take advantage of very low borrowing costs and proceed with projects cognizant that it may take somewhat longer to achieve full absorption on a project over the next two years than was true in the previous two years. Furthermore, HRM's Regional Plan is expected to be implemented next year with policies that encourage higher density development. Consequently, the current shift toward increasing density and a rising share of multiple unit starts is expected to be a key characteristic of the local housing market well beyond the forecast horizon of 15 months.

While rising land costs have challenged builders this year, building material price inflation has slowed and labour prices have generally stabilized. However, resumption in material and labour cost inflation is anticipated next year for several reasons. Locally, non-residential construction activity is expected to increase, generating higher demand for construction labour which will inevitably result in higher labour costs. In addition, there is concern about local building material and potentially even labour supply pressures and related cost inflation next year as the massive reconstruction effort on the U.S. Gulf Coast gets fully underway. Nevertheless, it is unlikely that these potential cost increases will be passed straight through to homebuyers, thus the forecast for a slower rate of new house price growth next year. Housing consumers are becoming increasingly price-sensitive and budget conscious and this will force producers to compete more fiercely and to demonstrate exceptional value in their products. Furthermore, consumers have become more accustomed to the higher quality of housing product that has prevailed in the local market in recent years. As a result, this combination of rising input costs, consumers' high quality expectations but price sensitivity, and concerns about home heating costs and property tax bills is expected to manifest itself in slightly smaller dwellings and a renewed focus on energy-efficient construction techniques and housing features.

## ECONOMIC OUTLOOK

**High Energy Prices and Buoyant Dollar Slow Pace of Economic Growth**

Expect a considerably slower pace of economic growth in Metro Halifax over the next 15 months as producers adjust to a buoyant Canadian dollar and consumers wrestle with high and volatile energy prices. Employment growth has already slowed this year- a trend is forecast to continue throughout 2006. With fewer jobs being created, net migration and overall household formation will be impeded, reducing demographic support for housing demand.

Despite continuing struggles in the manufacturing and energy industries, non-residential construction activity expansion will provide a much needed boost to a suffering goods sector. The $333 million Halifax Harbour Clean-Up project is now in full swing and the Halifax International Airport continues its expansion and improvements. These will be complemented by the $270 million Dartmouth Crossing retail park and required highway interchange, a $45 million Maritime Helicopter Training Centre at CFB Shearwater and continued construction and renovation of education facilities. As the pace of residential construction eases slightly over the next two years, these projects will be instrumental in supporting continued strength in the construction industry.

Unfortunately, the outlook for the much larger service sector is not quite as rosy. High and volatile energy prices have shaken consumer confidence and as inflation begins to creep upward, interest and mortgage rates are forecast to follow suit. Consequently, households will be spending more on home heating costs, gasoline, utilities and a host of other items whose price is indirectly influenced by oil prices. This will pose a significant challenge to the large retail trade sector which has been a key pillar of strength in the local economy in recent years. It will also continue to dampen tourism prospects and potentially, the transportation sector as well should energy prices remain elevated.

Fortunately, federal, provincial and municipal governments' respective fiscal situations are sufficiently healthy to allow continued public sector spending on programs and infrastructure. This is likely to continue to stimulate growth in health care, social services and education, which are absolutely essential sectors of the local economy.

In summary, high energy prices and exchange rates will pose a significant challenge to the Metro Halifax economy over the next 15 months. This will occur directly through weaker consumer confidence and indirectly through rising inflation, interest and mortgage rates. However, while the pace of economic growth will continue to slow, it is not expected to contract.

## RESALE MARKET OUTLOOK

**Expanding Inventory and Low Mortgage Rates Fuel Temporary Rebound in MLS® Sales**

After quite a weak year in 2004, resale market activity has rebounded impressively and is on track to end the year with close to 6,200 MLS® sales and annual average price growth of about 8 per cent. However, this surprising rally is not expected to endure as MLS® sales are forecast to slip five percent next year and average price growth is expected to decelerate to less than 4 per cent, reaching $195,000.

The outlook for the Metro Halifax resale market a year ago was somewhat uncertain with strong full-time employment growth fuelling some optimism about demand prospects but the spectre of rising mortgage rates and concerns about affordability casting some doubt on the possibility of an increase in sales. Not only did mortgage rate increases fail to materialize this year, long term rates have actually declined adding some ownership demand stimulus to that already generated by the vigorous growth in full-time jobs in 2004.

Perhaps more than any other factor, however, it is has been the spectacular increase in homes listed for sale that has enabled the rebound in MLS® sales this year. Active MLS® listings began to edge up late last year but really mushroomed in the first half of this year. On average at any given time so far in 2005 there have been about 900 more homes available for potential buyers to choose from than was the case last year. With increased selection across all price points, buyers have been more likely to find something to their liking and annual MLS® sales are now on track to post a 12 per cent increase this year after two successive years of declines. While the surge in inventory has helped maintain balanced market conditions in the face of higher demand, it has been ineffective in reducing the rate of growth in average sale price. Declining long-term mortgage rates and gains in real personal disposable income have allowed borrowers to increase their principal amounts, fuelling what is shaping up to be another year of stout average price growth of approximately 8 per cent.

Looking ahead to 2006, clouds are gathering on the forecast horizon for home ownership demand. Employment growth this year has been much weaker than expected and after generating over 7,000 new full-time jobs in 2004, the local economy is on track to produce barely more than 1,000 new full-time jobs this year and about the same number in 2006.

Once again this fall, the prevailing expectation is for moderate and steady increases in mortgage rates over the next 15 months as inflation creeps toward the upper boundary of the Bank of Canada's target range. Of particular concern in recent months has been the spike in energy prices and households' concerns about the related impact on their monthly budget. Consumer confidence has been soundly shaken by concerns about gasoline and home heating oil prices and with prices expected to remain elevated throughout next year, fewer potential buyers are enthusiastic about the prospects of 2006 being a good time to purchase a big ticket item such as a home.

Resale market supply is forecast to remain ample throughout next year with MLS® active listings peaking at 4,500 next June and the fastest supply expansion anticipated in the $250,000 plus segment. Accordingly, while balanced market conditions are expected to prevail through the first half of next year for the resale market in general, buyers' market conditions will materialize at the upper end of the market in the first half of the year and will likely spread across the price spectrum as the year progresses. Nevertheless, as has been the case this year, no definitive shift in buyer profile is anticipated in 2006 although buyers are generally expected to become even more price sensitive.

Dartmouth's (MLS® Areas 10 through 17) share of total MLS® sales has declined slightly this year while market share increased very slightly in Sackville (MLS® Areas 25 and 26) and Halifax County Southwest (MLS® Areas 9 and 40). No significant change in market share of total MLS® sales is anticipated to occur at the submarket level, but with HRM's Regional Plan likely to be implemented next year and gasoline prices remaining high, homebuyers can be expected to be thinking more about transportation and will likely demonstrate an intensified focus on location and neighbourhood amenities in their purchase decisions.

In summary, resale market activity has been unexpectedly robust this year with homeownership demand stimulated by surprisingly low and declining mortgage rates and a rapidly expanding inventory of homes for sale offering much more choice to buyers. However, while the inventory of homes for sale is forecast to remain more than sufficient to meet demand, high energy prices, weak employment growth and rising mortgage rates will curb home ownership demand and result in a modest decline in MLS® sales and a slower pace of growth in prices.

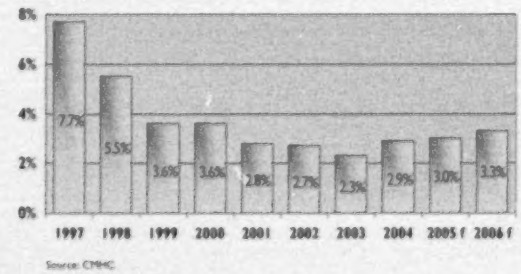
## RENTAL MARKET OUTLOOK

**Demand Continues to Sag But Rents Rise Due to Increasing Cost Pressures**

Expect the Metro Halifax rental vacancy rate to continue to creep upward over the next year but overall market conditions will remain balanced. This revised rental market forecast reflects weaker than anticipated rental demand this year continuing through 2006 but no change in our previous outlook for growth in rental supply. Despite the anticipated rise in vacancies, average rent growth is expected to exceed the rate of inflation this year and again next year as landlords attempt to pass rising operating costs through to tenants.

**Rental Vacancy Rate Rising But Still Quite Low**

Annual average rental apartment vacancy rate, Halifax CMA, (%)




Source: CMHC

As expected, there has been a sharp decline in the number of new rental units completed this year. Only 320 new rental apartments were completed in the second half of 2004 and the first half of 2005, well below the almost 900 rental units completed in the preceding 12 months. However, rental demand has also been considerably weaker than expected. Full-time employment for youth has contracted almost 3 per cent over the past year after two years of impressive gains and this has likely reduced the flow of young people to Metro as well as the movement of youth out of their parents' homes. In addition, long-term mortgage rates (the preference of most first-time homebuyers) have remained unexpectedly low over the past year and have actually declined more than half a percentage point since last fall. As if this were not sufficient incentive to attract more tenants to become homeowners, a tremendous surge in the inventory of existing homes for sale through MLS® has provided greatly expanded choice to potential first-time homebuyers. This combination of very low mortgage rates and a much greater selection of homes available has resulted in acceleration in the outflow of tenants into home ownership. As a result, we have revised our forecast for the 2005 Metro Halifax rental apartment vacancy rate to 3.0 per cent from 2.7 per cent.

Looking ahead to 2006, expect a strong rebound in new rental supply growth but continuing weakness in the demographic and economic conditions that support rental demand. Just over 800 rental apartments are forecast to complete construction and be added to the existing rental stock. However, youth employment conditions are not expected to improve over the next year, constraining a critical source of rental demand growth. In addition, the flow of renters becoming homeowners is expected to remain brisk over the next year with 5 year mortgage rates forecast to remain very low and anticipated further expansion of the inventory of homes for sale. Consequently, the rental vacancy rate is expected to increase modestly again next year to 3.3 per cent.

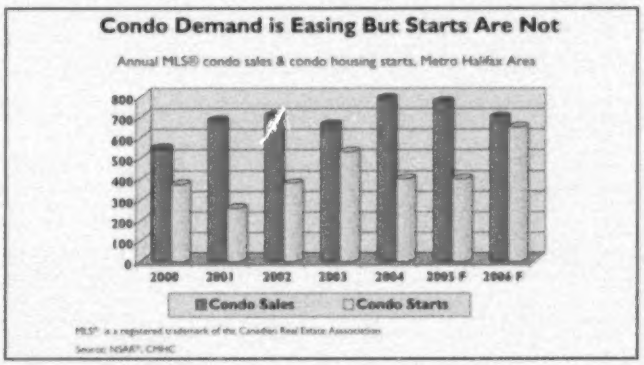
Despite sagging rental demand, average rent is expected to rise faster than inflation as landlords grapple with higher operating costs and attempt to recover recent investments in renovations of units and structures. Property tax assessments will continue to rise steadily through next year, heating costs are forecast to remain high and increased spending on advertising may be necessary to attract tenants in a softening market. Landlords will feel pressure to pass these costs through to tenants and will do so to the extent that balanced rental market conditions will allow. Consequently, average rents in Metro Halifax are now forecast to increase approximately 4 per cent this year and another 5 per cent in 2006.

## CONDOMINIUM MARKET OUTLOOK

**Strong Growth in Supply Is Forecast to Continue through 2006**

Growth in the local condo market has been truly exceptional in recent years. Condo sales through MLS® doubled in the seven year period between 1997 and 2004 and condo sales as a share of total residential MLS® sales also doubled over this period to 14 per cent last year. Average MLS® sale price for condos climbed 70 per cent from just under $100,000 in 1998 to just over $170,000 in 2004, reflecting the strong sellers' market conditions that persisted throughout this period. These conditions encouraged developers to introduce new condo projects to the market to satisfy increasing demand from potential buyers. In fact, there have been more than 2,000 new condo units started in Metro Halifax since the turn of the century and numerous projects are anticipated to begin construction over the next two years. By the end of this year 400 condo units will have started in 2005, matching last year's bustling level. Next year another 650 new condo starts are forecast to occur as several large, new projects reach pre-sales targets and break ground.

Most new condo projects over the past five years have been relatively luxurious, targeted at empty-nesters and more affluent renters who prefer the low-maintenance apartment lifestyle. However, it appears that the rapid growth in supply has finally caught up with demand as balanced market conditions have emerged in this segment of the condo market this year. Demand at the 'high end' remains quite healthy this year with condo sales over $250,000 accounting for more than 15 per cent of total condo sales through MLS®. However, the inventory of units for sale over $250,000 has expanded significantly, reducing pressure on potential buyers. While balanced market conditions in this segment of the condo market have not yet yielded a decline in sale to list price ratio (a key indicator of market condition), units are taking longer to sell than a year ago.




With a sharp rise in condo starts next year accompanying the strong rebound in rental starts that is already well underway, expect to see a rapid expansion in new supply of apartments on the local market over the next two years, particularly high-end units on the Halifax Peninsula. With these new rental and ownership apartments drawing to some extent on the same demand sources for occupancy, there is increased risk of a temporary period of oversupply and the related potential for decreased profitability for new luxury condo projects. It is anticipated that developers of new condo projects (again, particularly new luxury condo projects on the Halifax Peninsula) will expand the geographic scope of their marketing efforts well beyond Metro Halifax and Atlantic Canada in an attempt to entice expatriates and other migrants to their projects as offering relatively good value and quality of life.

Nevertheless, the location, style and features of new condo projects are expected to continue to gradually diversify as developers seek to broaden intrinsic market demand for condo living to appeal to a wider variety of potential local buyers. Examples of such new projects include a family-oriented neighbourhood of single-detached, semi-detached and townhouse condos in Dartmouth, buildings with condos priced

appropriately for first-time homebuyers in Halifax and innovative condo community concepts in Bedford/Hammonds Plains.

As growth in house prices continues to exceed household income growth, and with mortgage rates forecast to rise gradually over the next 15 months, more first-time buyers are expected to consider purchasing a condo as an affordable first home option. Consequently, demand for condos priced under $175,000 is expected to rise over the next two years. Unfortunately, developers will continue to find that high land and construction costs will make it difficult to build condo projects that include a large share of modestly-priced units to satisfy this growing demand. As a result, market conditions in this segment of the condo market are expected to remain in favour of sellers through the end of next year.

## FORECAST SUMMARY

### Metro Halifax- October 2005

| | 2003 | 2004 | 2005 F | % change | 2006 F | % change |
|---|---|---|---|---|---|---|
| **RESALE MARKET** | | | | | | |
| MLS® Active Listings (June peak) | 2,460 | 2,338 | 3,984 | 70.4% | 4,500 | 13.0% |
| Residential MLS® Sales | 5,813 | 5,516 | 6,200 | 12.4% | 5,900 | -4.8% |
| Residential MLS® Average Price | $ 162,486 | $ 175,132 | $ 188,500 | 7.6% | $ 195,000 | 3.4% |
| **NEW HOME MARKET** | | | | | | |
| Total Starts | 3,066 | 2,627 | 2,550 | -2.9% | 2,625 | 2.9% |
| Single-detached | 1,483 | 1,510 | 1,200 | -20.5% | 1,050 | -12.5% |
| Multiple Unit | 1,583 | 1,117 | 1,350 | 20.9% | 1,575 | 16.7% |
| Semi-detached | 227 | 142 | 125 | -12.0% | 100 | -20.0% |
| Row | 184 | 166 | 175 | 5.4% | 175 | 0.0% |
| Apartment | 1,172 | 809 | 1,050 | 29.8% | 1,300 | 23.8% |
| Condominium (all structure types) | 530 | 401 | 400 | -0.2% | 650 | 62.5% |
| Average New House Price (Single-detached) | $ 211,739 | $ 233,914 | $ 259,000 | 10.7% | $ 272,000 | 5.0% |
| **RENTAL MARKET** | | | | | | |
| Vacancy Rate | 2.3% | 2.9% | 3.0% | | 3.3% | |
| Average Rent- | $675 | $705 | $735 | 4.3% | $770 | 4.8% |
| Rental Housing Starts | 713 | 422 | 655 | 55.2% | 675 | 3.1% |
| **ECONOMIC OVERVIEW** | | | | | | |
| Mortgage Rate- 3 year term | 5.82% | 5.65% | 5.56% | | 6.00% | |
| Mortgage Rate- 5 year term | 6.39% | 6.23% | 6.00% | | 6.47% | |
| Employed | 195,208 | 202,821 | 205,300 | | 207,300 | |
| Employment growth | 2.3% | 3.9% | 1.2% | | 1.0% | |
| Unemployment rate | 6.8% | 6.1% | 5.9% | | 5.8% | |

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Source: CMHC
Statistics Canada: Labour Force Survey
Canadian Real Estate Association
Nova Scotia Association of Realtors

**Housing Market Outlook** (Order no. 7365E) is published 2 times a year in May and October for the Metro Halifax market. Annual subscriptions to **Housing Market Outlook** are $40.00 plus applicable taxes.

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